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### INDEPENDENT AUDITOR'S REPORT

June 30, 2003

The Honorable Ron Sims, County Executive  
King County  
Seattle, Washington

We have audited the accompanying basic financial statements of King County, Washington, as of and for the year ended December 31, 2002, as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the Public Transportation and Water Quality Enterprise Funds, which statements reflect total assets and revenues constituting 47% and 26%, respectively, of total County assets and revenues, and 91% and 94%, respectively, of total Business-Type assets and revenues. We also did not audit the Harborview Medical Center, which statements reflect total assets and revenues constituting 7% and 17%, respectively, of total County assets and revenues. The statements of the Public Transportation Fund, the Water Quality Fund and the Harborview Medical Center were audited by other auditors whose reports have been furnished to us, and our opinion insofar as it relates to the amounts included for King County is based solely on the reports of the other auditors.

We conducted our financial audit in accordance with governmental auditing standards generally accepted in the United States of America, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was performed pursuant to the *Revised Code of Washington* 43.09.260, under which a full report on the results of this audit will be issued. This report may include findings and recommendations on compliance matters, internal control procedures, and questionable costs or contingencies that would not be material in relation to the financial statements taken as a whole.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of King County, Washington, as of December 31, 2002, and the changes in financial position and cash flows, where applicable, thereof, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, during the year ended December 31, 2002, King County has implemented Governmental Accounting Standard's Board Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments, Omnibus*; and Statement 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards* in the United States of America, we will also issue our report on our consideration of the County's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis information on pages 3 through 20 and Infrastructure modified approach information on pages 118 through 119 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of King County's (the County) Comprehensive Annual Financial Report (CAFR) presents a narrative overview and analysis of the financial activities of the County for the year ended December 31, 2002. We encourage readers to consider this information in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the County's financial statements and notes to the financial statements, which follow.

Because the County is implementing new reporting standards for this fiscal year with significant changes in content and structure, much of the information is not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the County's financial position and results of operations.

### FINANCIAL HIGHLIGHTS – PRIMARY GOVERNMENT

- As of December 31, 2002, the assets of the County exceeded its liabilities by \$2.702 billion (net assets). Because all of the County's net assets are either invested in capital assets or restricted as to use, the combined unrestricted net assets showed a \$274.0 million deficit at the end of the year.
- In 2002, the County's total net assets increased by 9.2 percent or \$226.6 million. The governmental net assets increased by 21.3 percent or \$181.5 million, and the business-type net assets increased by 2.8 percent or \$45.1 million.
- As of December 31, 2002, the County's governmental funds reported combined ending fund balances of \$366.2 million. Approximately 59.9 percent or \$219.4 million is unreserved fund balance available for spending at the government's discretion within the purposes specified for the County's funds.
- At the end of 2002, the unreserved, undesignated fund balance for the general fund was \$60.2 million amounting to 13.3 percent of total general fund expenditures for 2002. Total fund balance for the general fund increased 9.8 percent or \$8.2 million for the year.
- The County's total bonded debt increased by \$36.5 million or 1.4 percent in 2002.

### OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the County's *basic financial statements* which include three components: (1) **government-wide** financial statements; (2) **fund** financial statements; and (3) **notes** to the financial statements. This report also contains additional *required supplementary information* and *other supplementary information* in addition to the basic financial statements.

#### **Government-wide Financial Statements**

The government-wide financial statements are designed to provide readers with a broad overview of the County's finances in a manner similar to a private sector business. The statements provide both short-term and long-term information about the County's financial position, which is useful in assessing the County's financial condition at the end of the fiscal year. These statements are prepared using the flow of economic resources measurement

focus and the accrual basis of accounting. This means they follow methods that are similar to those used by most businesses, taking into account all revenues and expenses connected with the fiscal year, even if cash involved has not been received or paid. The government-wide financial statements consist of the following two statements:

The **statement of net assets** presents all of the County's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in the County's net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating.

The **statement of activities** presents information showing how the County's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. As a result, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of the government-wide financial statements have separate sections for three different types of county programs or activities:

**Governmental activities.** The activities in this section are principally supported by taxes and intergovernmental revenues. Most of the County's basic services fall into this category, including general government; law, safety and justice; physical environment; transportation; economic environment; mental and physical health; and culture and recreation. Also included within the governmental activities are the operations of the County's four flood control zone districts, of which only one is currently active. Although legally separate from the County, these component units are blended with the *primary government* (King County) because of their governance relationship with the County.

**Business-type activities.** These functions are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities include the operation of the County's public transportation system, wastewater treatment facilities, solid waste disposal facilities, airport, and other services.

**Discretely presented component units.** The government-wide financial statements include not only King County itself, i.e., the *primary government*, but also two legally separate entities, the Harborview Medical Center (HMC) and the Washington State Major League Baseball Stadium Public Facilities District (PFD), for which the County is financially accountable. Financial information for these component units is reported separately from the financial information presented for the primary government itself.

### **Fund Financial Statements**

The fund financial statements are designed to report information about groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the County can be divided into three categories: **governmental** funds, **proprietary** funds, and **fiduciary** funds.

**Governmental funds.** Most of the basic services provided by the County are financed through governmental funds. Governmental funds are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial

statements. Unlike the government-wide financial statements, however, the governmental funds financial statements focus on (1) how cash and other financial assets can readily be converted to available resources and (2) the balances left at year-end that are available for spending. Such information may be useful in determining whether there will be adequate financial resources available to meet the current needs of the County.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The County maintains a general fund and several other individual governmental funds organized according to their type (special revenue, debt service, and capital projects). Two governmental funds, the General Fund and the Public Health Fund, are considered to be *major funds* for financial reporting purposes. Each of the major funds is presented in a separate column in the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major funds is provided in the form of combining and subcombining statements in the Governmental Funds section of this report, following the Basic Statements section.

The County adopts an annual budget appropriated at the department/division level for the General Fund and at the fund level for the Public Health Fund. A budgetary comparison statement has been provided for each of the two major governmental funds.

The basic governmental funds financial statements can be found immediately following the government-wide statements.

**Proprietary funds.** Proprietary funds are generally used to account for services for which the County charges customers a fee. Proprietary funds provide the same type of information as shown in the government-wide financial statements, only in more detail. Like the government-wide financial statements, proprietary funds financial statements use the accrual basis of accounting. There is no reconciliation needed between the government-wide financial statements for business-type activities and the proprietary funds financial statements. The basic proprietary funds financial statements can be found immediately following the governmental funds financial statements.

The County maintains the following two types of proprietary funds:

**Enterprise funds** are used to report the same functions presented as business-type activities in the government-wide financial statements. The proprietary funds financial statements provide separate information for the Water Quality Enterprise and the Public Transportation Enterprise, both considered to be major funds of the County for financial reporting purposes. All other enterprise funds are aggregated into a single presentation within the proprietary funds financial statements.

**Internal service funds** are used to report activities that provide services to the County's other programs and activities on a cost reimbursement basis. The County uses internal service funds to account for its motor pool, information and telecommunications services, construction and facilities management, risk management, employee benefits, and financial and various other administrative services. These services predominantly benefit governmental rather than business-type functions and have been included within governmental activities in the government-wide financial statements. These services are combined into a single, aggregated presentation in the proprietary funds financial statements. Two internal service funds that provide equipment and fleet maintenance and procurement for the two major enterprise funds are included within those business-type activities in the government-wide financial statements, and are combined into a single aggregated presentation within the business-type activities of the proprietary funds financial statements.

Individual fund data for each of the non-major proprietary funds is provided in the form of combining statements that can be found in the Proprietary Funds section of this report.

**Fiduciary funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds include the investment trust funds, used to report investment activity conducted by the County on behalf of legally separate entities such as special districts and public authorities that are not part of the County's reporting entity, and the agency funds. Since the resources of these funds are not available to support the County's own programs, they are not reflected in the government-wide financial statements. The accounting used for fiduciary funds is much like that used for proprietary funds. The basic fiduciary funds financial statements can be found immediately following the proprietary funds financial statements.

#### **Notes to the financial statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found immediately following the fiduciary funds financial statements.

#### **Other information**

**Required supplementary information.** In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* on infrastructure assets reported using the modified approach. The required supplementary information immediately follows the notes to the financial statements.

**Combining Statements.** The combining and subcombining statements, referred to earlier, are presented in separate sections immediately following the required supplementary information.

### **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

This is the first year that the County has presented its financial statements under the new reporting model required by Governmental Accounting Standards Board Statement No. 34 (GASB 34), *Basic Financial Statements – and Management's Discussion and Analysis (MD&A) – for State and Local Governments*. Because this reporting model significantly changes both the recording and presentation of financial data, the County has not restated prior fiscal years for the purposes of providing comparative information for the MD&A. In future years, when prior year information is available, a comparative analysis of government-wide information will be included in this report.

### **Analysis of Net Assets**

Net assets may serve over time as a useful indicator of a government's financial position. As indicated in the condensed financial information below, the County's combined net assets (governmental and business-type activities) were \$2.702 billion at the end of 2002. This is an increase of 9.2 percent or \$226.6 million over the previous year.

#### **Net Assets as of December 31, 2002 (in millions)**

	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total Primary Government</b>
<b>Assets:</b>			
Current and other assets	\$ 753.0	\$ 879.1	\$1,632.1
Capital assets	<u>1,647.7</u>	<u>2,760.6</u>	<u>4,408.3</u>
Total assets	<u>\$2,400.7</u>	<u>\$3,639.7</u>	<u>\$6,040.4</u>
<b>Liabilities:</b>			
Long-term liabilities	\$1,119.2	\$1,614.6	\$2,733.8
Other liabilities	<u>247.6</u>	<u>357.4</u>	<u>605.0</u>
Total liabilities	<u>\$1,366.8</u>	<u>\$1,972.0</u>	<u>\$3,338.8</u>
<b>Net Assets:</b>			
Invested in capital assets, net of related debt	\$1,148.0	\$1,124.5	\$2,272.5
Restricted	295.4	407.7	703.1
Unrestricted	<u>(409.5)</u>	<u>135.5</u>	<u>(274.0)</u>
Total Net Assets	<u>\$1,033.9</u>	<u>\$1,667.7</u>	<u>\$2,701.6</u>

**Governmental activities.** Although net assets of the County's governmental activities increased 21.3 percent to \$1.034 billion, all of the net assets are either invested in capital assets (e.g., land, buildings, infrastructure, right-of-way, equipment, and work in progress) less any related outstanding debt used to acquire those assets; or restricted as to use for such purposes as capital construction (\$152.3 million), debt service (\$44.4 million) or other legal and contractual requirements (\$98.7 million). Consequently, *unrestricted net assets* for governmental activities showed a \$409.5 million deficit at the end of 2002.

This deficit does not mean that the County's governmental activities do not have resources available to pay their bills in the coming year. This is supported by the increase in net assets for governmental activities in 2002, which reflects the County's ability to meet its current obligations in those activities including the related debt service requirements. The deficit in the unrestricted net assets is the result of the governmental activities having *long-term* commitments that are greater than currently available resources. Specifically, the County's governmental activities include general obligation debt of \$511.1 million for which no corresponding assets are recorded, but for which future revenues are obligated.

Of that amount, 68.6 percent or \$350.9 million is related to assets that are recorded on the books of the County's two discretely presented component units: the Washington State Major League Baseball Stadium PFD (\$267.8 million) and Harborview Medical Center (\$83.1 million). As discretely presented component units, neither entity is part of the primary government nor incorporated into this analysis. The remainder of the debt, for which there are no corresponding assets, consists of \$118.4 million associated with the imploded Kingdome facility and \$41.9 million used to finance assets that have been contributed by the County to other programs and services that benefit the citizens of the County.

**Business-type activities.** Net assets of the business-type activities increased by 2.8 percent to \$1.668 billion. Of the total net assets for business-type activities, 67.4 percent is invested in capital assets (e.g., land, buildings, vehicles, plant assets, equipment, and work in progress), net of related debt. The business-type activities use these capital assets to provide services to their customers, i.e., citizens; consequently, these assets are not available for future spending. The resources needed to repay the debt incurred to acquire these assets must be provided from other sources since the capital assets themselves cannot be liquidated for these liabilities. Another 24.5 percent of the total net assets for the business-type activities is restricted as to use for capital construction (\$292.1 million) and debt service (\$115.6 million). The remaining 8.1 percent or \$135.5 million is unrestricted net assets that may be used to finance the continuing operations of the County's business-type activities. Any balance in the unrestricted net assets for business-type activities cannot be used to reduce the unrestricted net asset deficit in governmental activities.

The combination of the \$409.5 million deficit in the governmental activities unrestricted net assets and the \$135.5 million positive balance in the business-type activities unrestricted net assets resulted in the deficit of \$274.0 million in total unrestricted net assets for the County as a whole.

#### **Analysis of Changes in Net Assets**

The increase in 2002 in the County's total net assets resulted from revenues exceeding related expenses and reflects the County's ability to meet its current operating and debt service requirements. Approximately 40.9 percent of the County's total revenues came from taxes, primarily property tax and the retail sales and use tax. Charges for various goods and services provided 30.9 percent of the total revenues, while 26.4 percent was derived from operating and capital grants and contributions (including state and federal assistance). The County's expenses cover a range of services, the largest of which were for public transportation; law, safety and justice; mental and physical health; and water quality.

The condensed financial information on the following page is derived from the government-wide Statement of Activities and reflects how the County's net assets changed during the fiscal year.

**Governmental activities.** Governmental activities accounted for 80.1 percent of the total growth in net assets of the County, resulting in an increase in the County's net assets of \$181.5 million. Program revenues for governmental activities total \$701.2 million and include the amount paid by those who directly benefited from the programs (\$230.3 million), and by other governments and organizations that subsidized certain programs with operating grants and contributions (\$387.8 million), and capital grants and contributions (\$83.1 million). In 2002 the cost of all governmental activities was \$1.098 billion. The County paid for the \$396.7 million remaining "public benefit" portion of governmental activities with \$390.7 million in property taxes, \$120.9 million in retail sales and use taxes, and \$67.4 million in other revenues including other taxes and interest earnings offset by the loss on the sale of capital assets. As discussed earlier, all of the increase in governmental activities net assets was either used to acquire capital assets to provide services to the County's citizens or subject to restrictions as to how it can be used,

**Changes in Net Assets  
For the Year Ended December 31, 2002  
(in millions)**

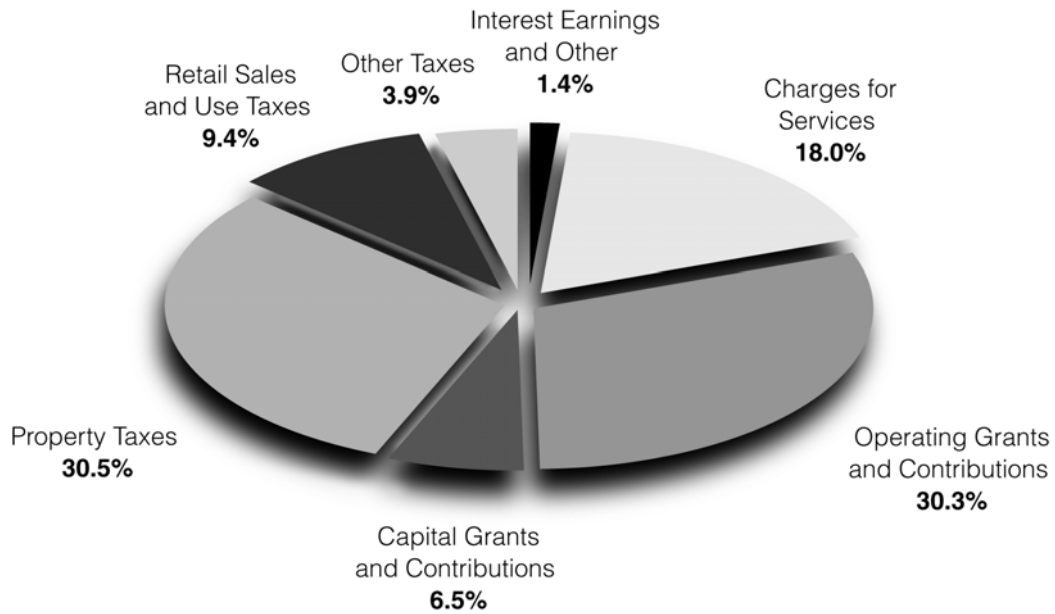
	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total Primary Government</b>
<b>Revenues</b>			
Program revenues:			
Charges for services	\$ 230.3	\$ 420.5	\$ 650.8
Operating grants and contributions	387.8	31.3	419.1
Capital grants and contributions	83.1	52.1	135.2
General revenues:			
Property taxes	390.7	-	390.7
Retail sales and use taxes	120.9	297.3	418.2
Other taxes	49.8	-	49.8
Unrestricted interest earnings	30.1	26.3	56.4
Loss on sale of capital assets	(12.5)	(4.1)	(16.6)
Total revenues	<u>\$1,280.2</u>	<u>\$ 823.4</u>	<u>\$2,103.6</u>
<b>Expenses<sup>1</sup></b>			
General government	\$ 43.3	\$ -	\$ 43.3
Law, safety and justice	462.8	-	462.8
Physical environment	51.6	-	51.6
Transportation	63.4	-	63.4
Economic environment	73.3	-	73.3
Mental and physical health	316.6	-	316.6
Culture and recreation	33.7	-	33.7
Interest and other debt service costs	53.1	-	53.1
Airport	-	11.8	11.8
Public transportation	-	446.2	446.2
Solid waste	-	79.3	79.3
Water quality	-	236.5	236.5
Other enterprise activity	-	5.4	5.4
Total expenses	<u>\$1,097.8</u>	<u>\$ 779.2</u>	<u>\$1,877.0</u>
Increase in net assets before transfers	182.4	44.2	226.6
Transfers	(.9)	.9	-
Increase in net assets	\$ 181.5	\$ 45.1	226.6
Net assets at beginning of year	<u>852.4</u>	<u>1,622.6</u>	<u>2,475.0</u>
Net assets at end of year	<u>\$1,033.9</u>	<u>\$1,667.7</u>	<u>\$2,701.6</u>

<sup>1</sup> Expenses for all functions include the allocation of indirect expenses from the general government function. The amount of indirect general government expenses allocated to each function is shown in a separate column on the County's government-wide Statement of Activities alongside the column that reflects the direct operating expenses incurred by each function. As a result of this allocation, the \$43.3 million in General government expense above consists of \$97.8 million in direct program expenses reduced by a net allocation of \$54.5 million to other County functions.

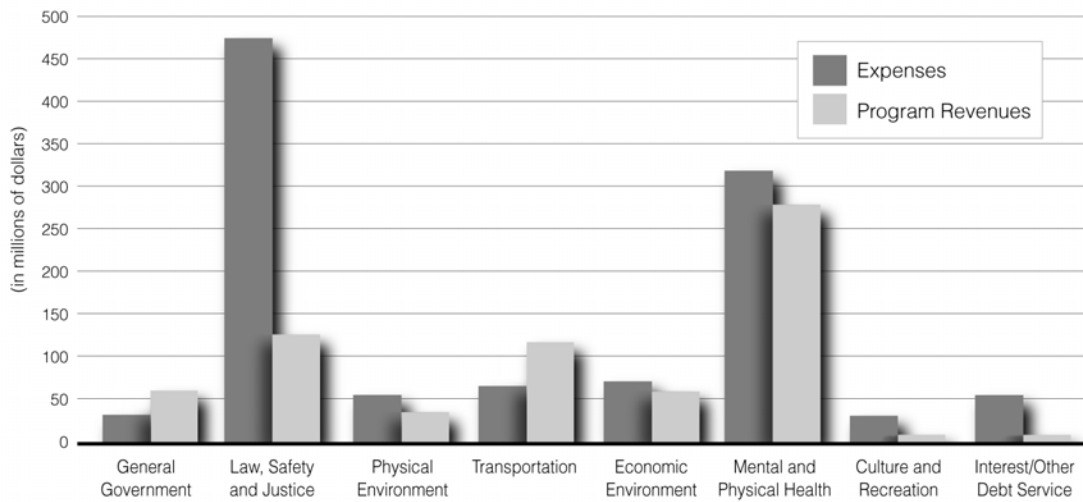
The charts on the following page illustrate the County's revenues by source and its expenses and program revenues by function for its governmental activities:



### Revenues by Source - Governmental Activities



### Expenses and Program Revenues - Governmental Activities



Property tax provided 30.5 percent, and operating grants and contributions 30.3 percent, of total revenues for governmental activities. The most significant expense amount is for Law, safety and justice, a function that requires the greatest usage of general government revenues. The primary revenue sources for Mental and physical health were charges for services and operating grants and contributions, which paid for 90.0 percent of the activities for that function. In 2002, Transportation received \$64.4 million in infrastructure capital assets (roads) from other local governments, a capital contribution that enabled program revenues to exceed expenses.

A comparison of the cost of services by function for the County's governmental activities is shown below, along with the revenues used to cover the net expenses of the governmental activities (expressed in millions):

**Expenses Net of Program Revenues:**

General government	\$ 16.0
Law, safety and justice	(336.1)
Physical environment	(8.9)
Transportation	55.0
Economic environment	(19.1)
Mental and physical environment	(31.5)
Culture and recreation	(26.3)
Interest and other debt service costs	(45.7)
Total expenses	<u>\$ (396.6)</u>

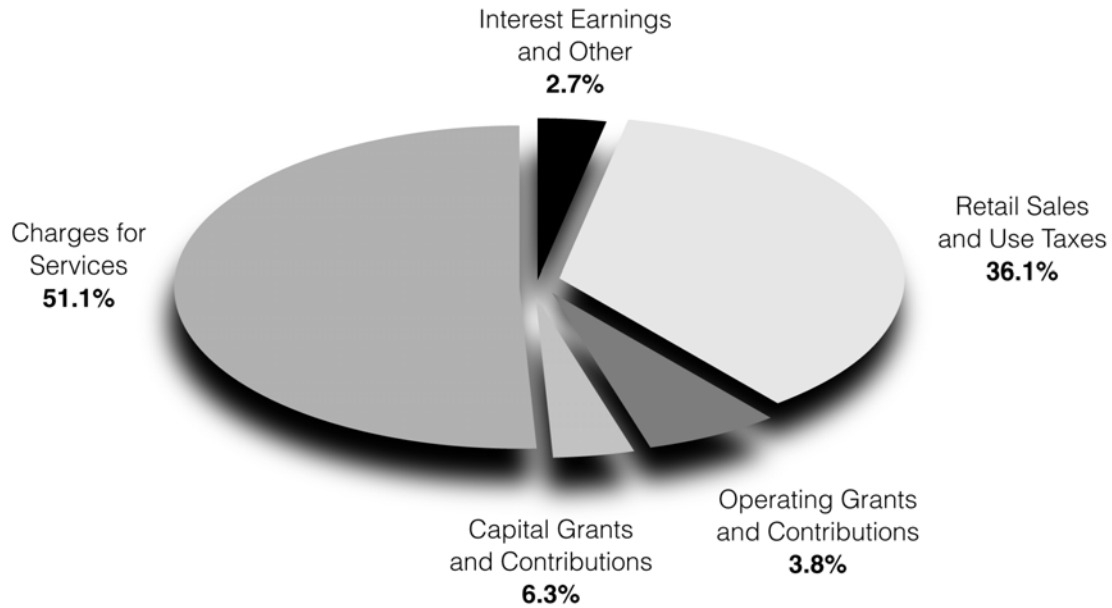
**General Revenues:**

Property taxes	390.7
Retail sales and use taxes	120.9
Other taxes	49.8
Unrestricted interest earnings	30.1
Other	(13.4)
Increase in net assets	<u>\$ 181.5</u>

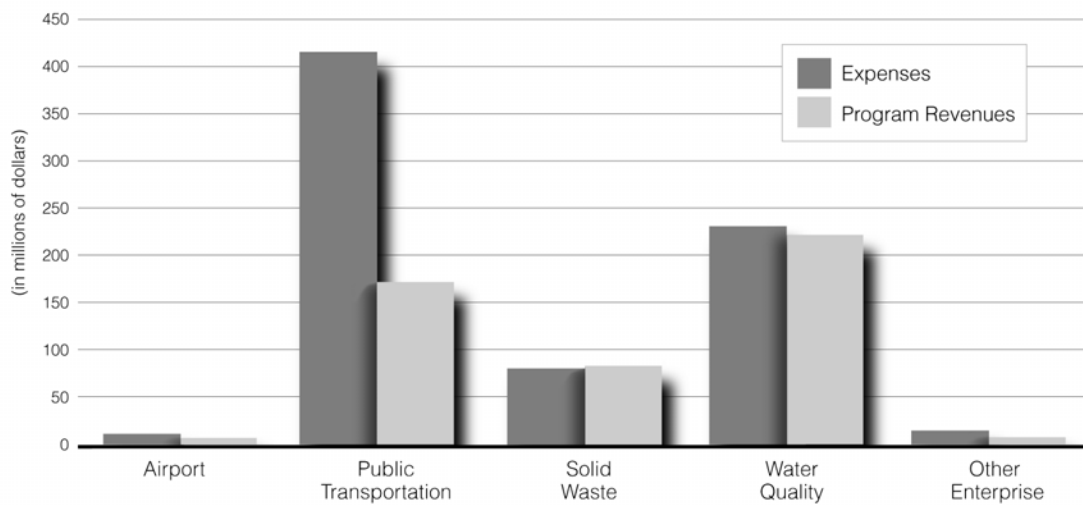
**Business-type activities.** Business-type activities increased the County's net assets by \$45.1 million, accounting for 19.9 percent of the total growth in net assets of the County. Total revenues for business-type activities were \$823.4 million. The cost of all business-type activities for 2002 was \$779.2 million. Of that amount, 64.7 percent or \$503.9 million was funded from program revenues, including \$420.5 million in charges for services, \$31.3 million from other governments and organizations that subsidized certain programs with operating grants, and \$52.1 million in capital grants and contributions. The Public Transportation program operations are subsidized with retail sales and use tax revenues, which amounted to \$297.3 million in 2002. In addition, the business-type activities received \$22.2 million in unrestricted interest earnings and other general revenue.

The charts on the following page illustrate the County's business-type revenues by source and business-type expenses and program revenues by function:

### Revenues by Source - Business-type Activities



### Expenses and Program Revenues - Business-type Activities



## FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

As noted earlier, the County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

### **Governmental Funds**

The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the County's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net financial resources available for spending at the end of the fiscal year.

At December 31, 2002, the County's governmental funds reported combined ending fund balances of \$366.2 million, an increase of \$27.1 million in comparison with the prior year. Approximately 59.9 percent (\$219.4 million) constitutes **unreserved fund balance**, which is available for spending in the coming year at the County's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed to liquidate existing contracts and purchase orders of the prior fiscal year (\$117.2 million), to pay debt service (\$17.2 million), or for a variety of other restricted purposes (\$12.3 million).

Governmental fund revenues overall totaled approximately \$1.259 billion for 2002, which represents an increase of 1.9 percent or \$23.8 million over the fiscal year ended December 31, 2001. In 2002 expenditures for governmental funds totaled \$1.277 billion, an increase of 0.4 percent or \$5.4 million from the previous fiscal year. Although the expenses for governmental funds exceeded revenues by \$18.5 million in 2002, this deficiency was half the \$36.9 million deficiency at the end of the 2001 fiscal year.

The **General Fund** is the chief operating fund for the County. At the end of the fiscal year, total fund balance for the General Fund equaled \$91.1 million, an increase of 9.8 percent of \$8.2 million for the year. Of the \$81.8 million in unreserved fund balance, \$21.6 million has been designated for working capital purposes and contingencies and is not considered available to spend. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 18.1 percent of total general fund expenditures, up from 15.7 percent a year ago. Total fund balance represents 20.2 percent of total general fund expenditures, up from 18.6 percent a year ago.

The fund balance of the County's General Fund increased by \$8.2 million during the current fiscal year. Key factors in this growth are as follows:

- \$15.8 million increase in property tax revenues along with a \$1.9 million increase in penalties and interest on delinquent property taxes largely as a result of higher tax collection rates, fueled in large measure by low interest rates in the second half of the year; secondary factors include a small amount of banked capacity from 2000 and a pretty solid year for new construction;
- \$2.2 million decrease in retail sales and use tax revenues due to a decrease in local retail sales as a result of the recession experienced in the area;
- \$4.9 million decrease in interest earnings due to market conditions;

- \$10.1 million decrease in operating expenditures due to prudent financial management by county departments and agencies in an effort to contend with required budget reductions which was offset by a \$13.8 million increase in law, safety and justice expenditures incurred as a result of increased expenses associated with the investigation and prosecution of significant legal cases.

The **Public Health Fund**, a special revenue fund, is used to finance health service centers located throughout the County and other public health programs. At the end of 2002, it had a total fund balance of \$10.3 million, of which \$5.5 million was unreserved and available for spending. Total revenues increased \$11.9 million, offset by a corresponding though smaller increase in expenditures of \$7.3 million. The increase in fund balance of \$4.4 million is due primarily to net increases in intergovernmental revenues related to the Title XIX Medicaid and FQHC (Federally Qualified Health Centers) patient generated revenues as a result of billing improvements in 2002 and catch-up billing from the previous year in such programs as clinical Dental Health, Family Health, Family Planning, and Sexually Transmitted Diseases.

### **Proprietary Funds**

The County's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities. This information is presented on the same basis of accounting, but provides more detail.

As discussed in the business-type activities above, the County's net assets increased by \$45.1 million as a result of operations in the proprietary funds adjusted to reflect the consolidation of internal service fund activities related to the enterprise funds. Of the two major proprietary funds, the Public Transportation Enterprise provided \$41.3 million of this increase while the net assets of the Water Quality Enterprise decreased by \$1.0 million.

The **Public Transportation Enterprise** accounts for the operations, maintenance, capital improvements, and expansion of public transportation and related facilities in the County under the King County Transit Division. At the end of 2002 the Public Transportation Enterprise had total net assets of \$1.141 billion of which 70.5 percent or \$804.0 million was invested in capital assets, net of related debt; 27.2 percent or \$310.2 million was restricted as to use for capital purposes and bond reserves; and 2.3 percent or \$26.4 million was unrestricted and available for spending. Net assets increased by \$41.3 million due to a \$9.5 million increase in sales tax revenues as a result of collecting a 0.2 percent increment to the sales tax subsidy for the full year; a \$14.5 million increase in federal operating subsidies and \$10.6 million increase in federal and state capital grant revenues; and a capital contribution of \$3.3 million in nonrevenue vehicles and \$5.1 million in associated replacement reserves from a related internal service fund to the Enterprise.

The **Water Quality Enterprise** accounts for the operation, maintenance, capital improvements, and expansion of the County's water pollution control facilities under the King County Wastewater Treatment Division. Total net assets for the enterprise were \$337.3 million at the end of 2002. 60.7 percent or \$204.8 million was invested in capital assets, net of related debt; 22.0 percent or \$74.2 was restricted as to use for construction projects and debt service; and the remaining 17.3 percent or \$58.3 million was unrestricted and available for spending. The decrease in net assets of \$1.0 million in 2002 is a significant improvement over the \$19.4 million decrease in 2001. The improvement (reduction in decrease of 94.9 percent) was attributable to positive operating results, principally due to a \$26.2 million increase in revenue from sewage disposal fees and capacity charge rates for new customers as a result of rate increases that took effect in 2002; and a reduction in electricity costs of \$7.1 million due to a decline in market rates and Water Quality's entry into long-term, reduced rate contracts with the local utility

provider. These net asset increases were offset by a \$3.7 million decline in nonoperating reimbursements and a \$10.3 million decrease in federal funding for Water Quality's Denny Way and Renton projects.

### **General Fund Budgetary Highlights**

The County's final general fund budget differs from the original budget in that it reflects an increase in appropriations of \$10.5 million. The Law, safety and justice function received \$10.0 million in supplemental appropriations needed for increased expenses related to the investigation and prosecution of significant legal cases. The supplemental appropriations were funded from available fund balance. During the year, total actual revenues exceeded budgetary estimates by \$8.8 million primarily due to higher than expected collections of penalties and interest on delinquent property taxes (\$1.7 million), imposition of fee increases to address the potential budget shortfall (\$3.5 million); and increases in transfers in from other funds (\$2.6 million). Total expenditures were less than budgetary estimates by \$21.6 million as a result of significant efforts made by county departments and agencies to provide required budget reductions within their programs.

The County's fiscal policies provide that the ending unreserved, undesignated *budgetary* fund balance for the general fund be planned at between 6.0 and 8.0 percent of estimated annual applicable general revenues. For 2002 the ending budgetary fund balance for the general fund, after deducting planned reserves and designations totaling \$65.7 million, amounted to \$25.4 million, which is approximately 6.0 percent of the \$423.3 million in applicable general revenues for the year.

## **CAPITAL ASSETS, INFRASTRUCTURE, AND DEBT ADMINISTRATION**

### **Capital Assets**

The County's investment in capital assets for its governmental and business-type activities as of December 31, 2002, amounts to \$4.408 billion (net of accumulated depreciation). This investment in capital assets includes land, right-of-way, farmland development rights, buildings, building improvements, improvements other than buildings, roads and bridges infrastructure, vehicles, machinery and equipment, furniture, and construction in progress. The total increase in the investment in capital assets for 2002 was 7.1 percent or \$292.3 million. Investment in capital assets increased in governmental activities by 10.2 percent or \$151.8 million and in business-type activities by 5.3 percent or \$140.5 million.

Major capital asset events during 2002 included the following:

- Construction commenced on the King County Courthouse seismic project, which will provide for the seismic retrofit and code-required fire and safety systems upgrades. As of year-end, construction in progress reached \$13.5 million.
- The year 2002 showed an acceleration of construction in the Sammamish Plateau Access Road (SPAR) – North Link project. The project provides for the construction of a multi-lane principal arterial needed to serve the anticipated growth in the area. About \$17.0 million was spent this year in construction and right-of-way acquisition.
- Also underway is the construction of the Regional Communications and Emergency Coordination Center (RCECC). This building will accommodate the current and future space and facility requirements of the Sheriff's Office 911 Communications Center and the Office of Emergency Management. About \$8.9 million was spent in 2002 with life-to-date construction in progress reaching \$12.1 million.

- During 2002, King County turned over some of its smaller parks facilities to cities and non-profit organizations as part of its strategy of concentrating only on regional parks. This included land, buildings, and park facilities at a net book value of about \$2.0 million.
- Capital assets of the Water Quality Enterprise increased by \$82.6 million during 2002. The increase is a result of replacement and additions to the interceptor and siphon systems, completion of a pump station, extensions of sewer trunk lines, and continued efforts to control odor and improve sewage-handling technology. \$80.0 million was spent on construction in progress that includes the Denny Way Combined Sewer Overflow (CSO), conveyance systems, Henderson/Martin Luther King Way CSO, North Creek storage facility, and feasibility studies and planning for the proposed Brightwater Treatment Plant.
- Capital assets of the Transportation Enterprise increased by \$46.6 million during 2002. The change is a result of additions to the bus fleet (100 trolleys were purchased and equipped during the year), upgrades to operating facilities, and investment in operational software. The increase of \$33.9 million in construction in progress related to further system-wide improvements and expansion of the fleet, maintenance facilities, service routes infrastructure, and park-and-ride and transit-oriented development.

More detailed information on the County's capital assets can be found in Note 6 – Capital Assets of this report.

**KING COUNTY's Capital Assets**  
(net of depreciation)  
(in millions)

	<b>Governmental activities</b>		<b>Business-type activities</b>		<b>Total</b>	
	<b>2002</b>	<b>2001</b>	<b>2002</b>	<b>2001</b>	<b>2002</b>	<b>2001</b>
Land	\$ 507.9	\$ 476.5	\$ 204.6	\$ 181.2	\$ 712.5	\$ 657.7
Buildings and improvements	349.3	363.2	1,327.4	1,287.5	1,676.7	1,650.7
Infrastructure	603.0	501.6	-	-	603.0	501.6
Equipment	76.4	70.5	765.5	808.0	841.9	878.5
Construction in progress	111.1	84.1	463.1	343.4	574.2	427.5
Total	<u>\$ 1,647.7</u>	<u>\$ 1,495.9</u>	<u>\$ 2,760.6</u>	<u>\$ 2,620.1</u>	<u>\$ 4,408.3</u>	<u>\$ 4,116.0</u>

**Infrastructure**

The County has elected to use the *modified approach* as defined in GASB 34 for infrastructure reporting for its roads and bridges. Under the modified approach, asset condition is reported rather than recording depreciation. The rating scales for pavements (roads) and bridges are further explained in the required supplementary information, which follows the notes to the basic financial statements.

The County performs condition assessments on its network of roads through the King County Pavement Management System, which generates a Pavement Condition Index (PCI) for each segment of arterial and local access road in the network. The PCI is a numerical index on a 100-point scale that represents the pavement's functional condition based on the quantity, severity, and type of visual distress. Condition assessments are undertaken every two years.

It is the policy of the King County Roads Division to maintain at least 80 percent of the road system at a PCI of 40 or better. In the most recent condition assessments, 93.4 percent of the arterial roads in the County and 89.4 percent of the local access roads in the County had a PCI rating at 40 and above. The majority of roads that fall below the established rating are local access roads that are situated in rural areas. The amount budgeted in 2002 for road maintenance was \$37.0 million. The amount actually expended was \$35.0 million. Underspending of the budgeted amount is a result of the removal of roads from the project list because of conflicts with anticipated utility work, cost efficiencies related to a relatively few roads to be resurfaced in remote locations, and weather-related work reductions or stoppages.

The County currently maintains 181 bridges. Physical inspections to uncover deficiencies are carried out at least every two years and documented in an inspections report. There is also an annual evaluation to determine which bridges are candidates for replacement or rehabilitation using a 10-point priority scale based on various factors of bridge condition to develop a ranking order. A key element in the priority scale is the sufficiency rating, which is a numerical rating (on a 100-point scale) of a bridge based on its structural adequacy and safety, essentiality for public use, and its serviceability and functional obsolescence. The policy of the King County Roads Division is to maintain bridges in such a manner that no more than 12 (6.6 percent) will have a sufficiency rating of 20 or less. As of December 31, 2002, there were 11 bridges in this category. The amount budgeted in 2002 to maintain and preserve bridges was \$4.2 million. Actual amounts expended were \$3.8 million.

#### **Debt Administration**

At December 31, 2002, King County had total bonded debt outstanding of \$2.571 billion. Of this amount, \$1.618 billion is comprised of debt backed by the full faith and credit of the County and \$137,000 is special assessment debt for which the government is liable in the event of default by the property owners subject to the assessment. The remainder of the County's bonded debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

#### **King County's Outstanding Debt General Obligation and Revenue Bonds (in millions)**

	<b>Governmental Activities</b>		<b>Business-type Activities</b>		<b>Total</b>	
	<b>2002</b>	<b>2001</b>	<b>2002</b>	<b>2001</b>	<b>2002</b>	<b>2001</b>
General obligation bonds	\$ 900.1	\$ 923.8	\$ 633.3	\$ 654.8	\$ 1,533.4	\$ 1,578.6
General obligation bond anticipation notes	85.0	65.0	-	-	85.0	65.0
Special assessment debt with governmental commitment	0.1	0.2	-	-	0.1	0.2
Revenue bonds	-	-	952.4	890.6	952.4	890.6
<b>Total</b>	<b>\$ 985.2</b>	<b>\$ 989.0</b>	<b>\$ 1,585.7</b>	<b>\$ 1,545.4</b>	<b>\$ 2,570.9</b>	<b>\$ 2,534.4</b>

The County's total bonded debt increased by \$36.5 million (1.4 percent) during the 2002 fiscal year. The key factors in this increase were the issuance of a \$38.3 million limited tax general



obligation bond issuance to provide financing for road improvements and \$100.0 million in Sewer Revenue Bonds to finance Wastewater Treatment Division's capital needs.

During the 2002 fiscal year, the County refinanced some of its existing debt to take advantage of favorable interest rates:

- The County issued two series of general obligation bonds to refinance two previously outstanding limited tax general obligation bonds that were financed by special taxes and revenue sources and by the public transportation sales tax. The result of these refundings is expected to decrease future aggregate debt service payments by \$29.8 million.
- The County completed a partial defeasance of \$7.0 million of limited tax general obligation (baseball stadium) bonds using excess proceeds from special taxes and revenues.
- The County also entered into sewer revenue bonds refinancing that is expected to decrease future aggregate debt service payments by \$29.3 million.

As of December 31, 2002, the County had short-term limited tax general obligation bond anticipation notes of \$85.0 million outstanding with a maturity date of October 1, 2003. The County issued the notes to finance the King County Courthouse seismic project and other building construction and improvement projects. A portion of the proceeds from these notes was used to pay and retire 2001 notes that matured on October 1, 2002.

The County maintains a rating of "Aa1" from Moody's and "AA+" from Standard & Poor's for its limited tax general obligation debt, and a rating of "Aaa" from Moody's and "AA+" from Standard & Poor's for its unlimited tax general obligation debt. The ratings are "A1" from Moody's and "AA-" from Standard & Poor's for the County's Wastewater Treatment Division's revenue debt.

State statutes limit the amount of general obligation debt a governmental entity may issue. The current debt limitation for the County's general county purposes and metropolitan functions is \$5.625 billion each, which is significantly in excess of the County's outstanding general obligation debt.

In March 2003 the County completed two refunding bond issues. It sold \$108.8 million unlimited tax general obligation bonds to refund the outstanding 1993C bonds and \$96.5 million of sewer revenue bonds to refund the 1995 bond issues.

Additional information on the County's debt can be found in this report in Note 12 – Debt.

### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

- Property value growth has slowed significantly, with assessed valuation up just 6.6 percent in 2002, compared with a 12 percent growth in 2001 and a 13.3 percent growth in 2000. The decline is attributable to the ailing commercial market.
- Sales tax receipts in the County (excluding those collected for public transportation) declined for the second consecutive year, falling 3.1 percent in 2002, after dropping 3.3 percent in 2001, the first decline since implementation of the local option sales tax in 1971.

- Unemployment remained relatively high at roughly 66,400 workers or 6.5 percent over the course of 2002. The tight labor market for skilled technical workers of the late 1990s is now characterized by a surplus, with a growing list of defunct internet-related firms.
- In 2002 there were no large annexations or incorporations. 2000 census data confirmed the continued decline in the county's unincorporated area population while overall County population grew. Between 1990 and 2000, the county's population grew from 1.5 million to 1.7 million. In 1990, more than 500,000 people lived in unincorporated King County; by 2000, this had declined to 350,000. The fiscal impacts of annexation and incorporation on the County depend on the revenue-generating capacity of an area compared with its service demands. Many of the remaining unincorporated urban areas of the County do not generate significant commercial activity and sales tax revenues, although these areas have relatively high service demands.
- Washington State Initiative Measure No. 747 (I-747) was approved by the State's voters in November 2001. I-747 reduced the limit on the total dollar amount of regular property taxes that may be levied annually by a taxing district (including the County) without a vote of its electors from 106 percent to 101 percent of the highest levy in the three previous years excluding new construction, improvements and state-assessed property. Because I-747's limitation applies to the dollar amount levied rather than to levy rates, increases in the value of existing property exceeding one percent per year will result in decreasing tax levy rates.

By law, the County is required to adopt a balanced budget. The entire 2003 budget for the County, adopted by the County Council in November 2002, totals \$3.1 billion. Of this amount, \$489.0 million is appropriated for the Current Expense Fund (General Fund); \$1.8 billion for public transportation, solid waste, wastewater treatment and public health; and \$855 million is committed to capital improvements for roads, parks, and other major public facilities.

A structural deficit in the general fund budget continues to persist due primarily to the constraints on property tax growth as a result of passage of I-747 and little improvement in the economy due to the persistent recession that began in 2001, along with growing demands on the criminal justice system. The County responded to this structural deficit by significantly reducing spending in the 2003 general fund budget. Expenditure cuts totaling \$52 million were enacted, with major cuts in parks (\$10.2 million), criminal justice (\$12.6 million), and human services (\$10.8 million). The general fund financial plan for 2003 includes ending with an unreserved, undesignated budgetary fund balance of \$25.3 million, which represents 6.0 percent of applicable general revenues.

### **REQUESTS FOR INFORMATION**

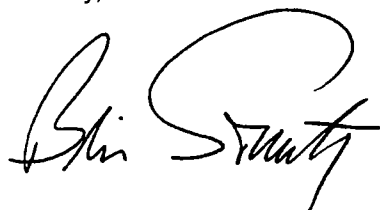
This financial report is designed to provide a general overview of the County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Manager, Financial Management Section, Room 653 Administration Building, 500 Fourth Ave., Seattle, WA 98104.

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The other data included in this report, designated as the statistical section in the table of contents, has not been audited by us and, accordingly, we express no opinion on such data.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying introductory section, pages I through xvi; combining and individual nonmajor fund financial statements, pages 121 through 231, and statistical tables pages 237-256; are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements taken as a whole. The introductory section and the statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Sincerely,

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with the first name "Brian" and last name "Sonntag" clearly distinguishable.

**BRIAN SONNTAG, CGFM**  
STATE AUDITOR